



MICHAEL F. HANNLEY
PRESIDENT & CEO

April 10, 2006

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

Re: Commercial Real Estate Lending

Dear Secretary Johnson:

I have read with interest the proposed guidance on Concentrations in Commercial Real Estate Lending, and wish to provide some comments.

Capitol Bancorp Limited is a bank development company holding 42 individually chartered community banks. Our banks focus on meeting the banking needs of their communities. We have focused, and will continue to focus, on financing the business real estate needs of the community and will finance other real estate projects for relationship customers who are diversifying their investment portfolios. We will also finance transaction real estate projects to a much lesser degree.

The proposal, as written, will hamper our ability to provide this service to the communities we serve.

Specifically:

The setting of arbitrary thresholds¹ for real estate exposure, which if exceeded would subject the bank to heightened scrutiny and possibly higher capital requirement levels, would not only discourage our banks from providing well supported and documented real estate secured loans, but would drive the banks to look for other areas or investments to deploy their funds. For example, in order to sustain revenue growth, community banks could be forced into lines of business which are historically more risky (i.e. consumer lending, credit cards, leasing) and more dependent on efficiencies of scale (i.e. consumer loans, working capital loans). In addition, history has demonstrated that the scarcity of real estate loans causes the very depreciation in real estate values that the agencies are concerned with. We do not feel a repeat of the "credit crunch" that occurred in the New England and Southwestern states, but this time on a broader national basis, is in the best interest of the industry nor the United States economy.

¹The proposal places the responsibility for setting portfolio hold limits on bank directors. Since the agencies have already taken a position on concentration thresholds and setting such limits is an arbitrary exercise, it is unreasonable to believe the directors will deviate from the arbitrary guidelines already established by the agencies.

- The regulatory agencies are understandably attempting to avoid a repeat of the real estate crisis that devastated the thrift industry. However, regulatory actions to mitigate the underlying causes of that crisis such as excessive advance ratios, undisciplined appraisers, equity interests and fraud have been undertaken.
- The setting of arbitrary limits for a geographically area most likely would limit our Bank's ability to make "in-market" loans, the primary reason for the existence of community banks.
- Setting underwriting criteria to a "secondary market" standard would be difficult, based on the limited number of secondary markets available to community banks, and would also severely limit the judgmental aspects of our loan approvals. Better said, if all banks must underwrite to a specific standard, is there a need for community banks? This same argument also applies to the pricing of loans in that we must make these decisions on a judgmental basis and not on a "modeled" basis. We are relationship bankers who know our customers and can price our loans. We urge the regulatory agencies to consider such "soft information" rather than making commercial real estate loans a commodity.
- It seems ironic that banks may be required to maintain higher levels of capital because their portfolios are concentrated in the type of loans that a bank is best equipped to underwrite. Logic would dictate that higher capital levels would be necessary for banks that make loans outside of their expertise or those loan types that have historically demonstrated higher industry net loss experience. To force banks to have higher capital ratios merely because they have concentrations in commercial real estate loans, possibly one of their core competencies, seems misguided.
- We agree that "owner occupied" loans should be excluded from this guidance. However, a clear definition of "owner occupied" should be rendered that includes properties that are owned by principals that may be operating through another entity such as a limited liability company.
- MIS and stress testing are clearly good tools for the management of a loan portfolio where the loans are underwritten using a model. Changing a decision point in a model will provide a good indication of possible future performance, assuming the model has been adequately validated. However, in community banking where judgmental decisions are made based on our intimate knowledge of the market and the borrower (and the guarantors), stress testing would be driven down to the loan level, making it cost prohibitive.

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- Defining capital requirements on a bank-by-bank basis would be subjective at best. Some banks would be placed at a competitive disadvantage, depending on the decision by the examiners. Well-capitalized banks, as currently defined, must be allowed to operate at maximum levels to provide reasonable returns to our shareholders.

In summary, much more thought must go into this proposal to make it effective, reasonable and equitable for all banks, and most specifically, community banks. Arbitrary limits on loan type concentrations, geographical concentrations and monitoring standards will create more stress in the banking system as well-managed and well run banks would be forced to move away from making quality real estate loans. Instead, it would force banks into other lending or market areas, which very well could increase the risk profile of the bank.

We are in agreement that sound underwriting practices, proper portfolio monitoring and managing LTV guidelines exceptions are a vital part of our continued success.

Please contact the undersigned with any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael F. Hannley", written over a horizontal line.

Michael F. Hannley
President & CEO